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No. 94-1337

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

LIBERTY MUTUAL INSURANCE CO.,
Petitioner,

v.

CHEMSTAR, INC. AND NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURGH, PA.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF IN OPPOSITION

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

1. Whether the district court's exercise of its discretion under Fed. R. Civ. P. 42(b), to bifurcate trial in a diversity suit concerning an insurer's duty to defend under state law violated *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), and the Rules Enabling Act.

2. Whether the imposition of punitive damages against an insurance company violated the Due Process Clause where the award (i) was based on clear and convincing evidence that the defendant acted with fraud, oppression or malice; (ii) was limited to five times the amount of compensatory damages; (iii) constituted less than two-thirds of one percent of the defendant's policyholder surplus; and (iv) was fully reviewed by the district court and the Ninth Circuit Court of Appeals and affirmed by both courts in written decisions.

PARTIES

Respondent Chemstar, Inc. was the plaintiff below and is a corporation whose parent and affiliated companies have not issued shares to the public. The following parties appeared by way of Chemstar's complaint or third party claims: Liberty Mutual Insurance Company; National Union Fire Insurance Company of Pittsburgh, Pennsylvania; Industrial Insurance Company of Hawaii LTD.; Genstar Corporation; American Home Assurance Company; Employer's Insurance of Wausau; and United Insurance Company.

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BRIEF IN OPPOSITION

Respondent Chemstar, Inc. ("Chemstar") submits this brief in opposition to Liberty Mutual Insurance Company's ("Liberty") Petition for Writ of Certiorari.

STATEMENT OF THE CASE [1]

Petitioner seeks review of one of three decisions by the United States Court of Appeals for the Ninth Circuit affirming the trial court's disposition of a diversity action, applying state law, involving an insurance coverage dispute with an insurer. The case arose out of the bad

[1] This Statement is limited to a discussion of the facts relevant to the petition now before the Court and does not attempt a complete description of the trial proceedings below. In the interest of brevity, Chemstar also incorporates by reference the statement of the facts in the main opinion below, set forth at Pet. App. 8a-10a.

faith denial of a defense by Liberty in dozens of property damage claims brought against Chemstar. The district court found Liberty's conduct to be unprecedented. As the district court stated: "The factors in the case were as egregious as the court has ever seen in an insurance bad faith case once in 20 years as a judge." (Pet. App. 79a)[2]

Following extensive pre-trial discovery, the district court granted summary judgment against Liberty holding, on the basis of undisputed facts, that Liberty had a duty to defend Chemstar under well-settled California law. (Pet. App. 60a-62a) After a subsequent jury trial, judgment was also entered upon special verdict findings that Liberty breached its duty of good faith and fair dealing to Chemstar, and acted with oppression, fraud or malice, in completely withdrawing from the defense of Chemstar in numerous property damage cases. Based on these findings, the jury awarded Chemstar actual and compensatory damages of approximately $2.8 million and punitive damages of $14 million. (Pet. App. 68a-71a)

The district court reviewed the entire record in denying Liberty's motion for a new trial, and found that the jury's determinations "were solidly based in the evidence." (Pet. App. 79a) The court of appeal likewise reviewed the entire record and unanimously affirmed the judgment. (Pet. App. 26a) Liberty now challenges that decision.

Factual Background

This diversity action arose out of 28 claims brought by homeowners in Southern California against Chemstar. Those homeowners alleged that lime manufactured and sold by Genstar Lime Company ("Genstar Lime"), Chemstar's predecessor, was defective and resulted in property damage to their homes. (Pet. App. 8a-9a) Genstar Lime gave notice of the first plaster claims to Liberty in July 1986, during the period of its comprehensive general liability insurance policies with Liberty. After Genstar

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[2] Citations to "Pet. App. ——" refer to the Appendix to the petition for writ of certiorari filed by Liberty.

Lime was sold and merged into Chemstar, Chemstar continued to give notice of the plaster pitting claims to Liberty. (SUPP 108, 135)[3]

For three years Liberty defended the claims and never issued a reservation of rights. However, in 1989 Liberty abruptly withdrew from the defense of all plaster cases against the recommendation of its own claims personnel. (SUPP 50, 216) At trial, Liberty contended that it had just found out about the sale and merger of Genstar Lime into Chemstar, and that Chemstar did not qualify as an insured under the Liberty policies. These contentions were directly contradicted by oral and documentary evidence, including the following:

1. The trial record was replete with written evidence of Liberty's awareness of its obligations to defend Chemstar. Liberty sent Special Claims Service instructions to every Liberty office. Those instructions made clear that Liberty was aware of the sale of Genstar Lime to Chemstar and was aware of its responsibility to defend Chemstar. (SUPP 2)

2. Liberty's principal witness, Frank Overman ("Overman"), admitted at trial that the plaster claims constituted a single occurrence which began during Liberty's coverage. (RT 1479-80; SUPP 201) Nevertheless, Liberty withdrew its defense in any and all plaster claims, violating Liberty's own Special Claims Service instructions.

3. Liberty had settled one early plaster case for nearly $1 million. This settlement required approval at the highest levels of Liberty's senior management and took place after Liberty's Home Office examiner had analyzed the policy and concluded that Chemstar qualified as "an insured entity." (SUPP 72) Yet Overman never even

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[3] SUPP refers to Chemstar's supplemental excerpts of record submitted with its briefing in Phase I of the appeal in the Ninth Circuit. EOR refers to Liberty's excerpts of record submitted with its briefing in Phase I. RT signifies the Reporter's Transcript from the Phase I trial, and CR signifies the clerk's record.

spoke to the examiner before he withdrew the defense from Chemstar. (RT 1420; SUPP 224)

4. The attorney retained by Liberty to defend Chemstar advised Liberty that "Chemstar, Inc. is in fact the successor-in-interest of Genstar Lime" and recommended that Chemstar be defended. (SUPP 105) Liberty ignored the recommendation.

5. Liberty disregarded the recommendations of its regional claims specialist, William Durcho, who wrote to the Home office that Liberty should continue to defend Chemstar. (SUPP 50, 57) Overman did not even attempt to contact Durcho to discuss this recommendation. (RT 261, 1409-1411; SUPP 190, 214)

6. Before withdrawing its defense, Liberty did not give Chemstar any prior warning so that Chemstar could at least submit information to demonstrate its right to a defense. (RT 1473; SUPP 199) As the district court noted, Liberty failed to make even the most simple and obvious inquiry. (Pet. App. 78a)

7. Liberty never issued a reservation of rights letter to Chemstar. Nevertheless, after investigating and defending the plaster claims for three years, Liberty did not even communicate its withdrawal decision directly to Chemstar, but left Chemstar to fend for itself with no explanation as to why Liberty had suddenly reversed its position. (Pet. App. 78a)

8. Liberty repeatedly advised the homeowners in writing that Liberty would pay all reasonable and necessary expenses required to repair their homes. (Pet. App. 78a) After three years of these promises, Liberty abruptly withdrew from the defense, leaving Chemstar to face numerous angry homeowners who vented their frustrations on Chemstar by filing suits for compensatory and punitive damages. When asked about the impact on Chemstar, Overman replied it was "pretty obvious." (RT 1475-76; SUPP 225-26)

Liberty's conduct represented an especially flagrant violation of its duties to its insured. In denying Liberty's post-trial motions, the district court stated, "On these facts it would be surprising if the jury did not find bad faith, and of course it did." (Pet. App. 78a)

Procedural History

Chemstar filed this action in Los Angeles Superior Court on March 13, 1990, alleging claims for breach of contract, breach of the covenant of good faith and fair dealing, and declaratory relief against Liberty. Chemstar also brought a claim for declaratory relief against another primary insurer and an excess insurer. Liberty removed the action to the United States District Court for the Central District of California on the basis of diversity of citizenship. (CR 1, 1-4)

In November, 1990, Liberty then filed a third-party complaint (CR 66) which resulted in three more insurance companies being drawn into the action, two of which moved to vacate the dates for the discovery cut-off and the pre-trial conference. (CR 97, 116, 124) The district court scheduled a new status conference to discuss a revised trial schedule. (CR 184) Thereafter, at the status conference, Chemstar requested a separate trial on the duty to defend issues, to the extent they were not resolved on summary judgment. (RT 7/22/91 at 64-65) With the exception of Liberty, all insurers agreed with Chemstar's request for a bifurcated trial. The district court then bifurcated the duty to defend issues between Liberty and Chemstar from the remainder of the case. (Pet. App. 57a-58a; RT 7/22/91 at 76; CR 234)

Under the trial court's bifurcation order, the first phase of the lawsuit ("Phase I") involved the application of settled principles of California law to issues relating to Liberty's duty to defend Chemstar under the comprehensive general liability insurance policies. The second phase of this action ("Phase II") involved the separate and dis-

tinct issues regarding ultimate indemnification obligations of Liberty and other insurers under California law for the property damage claims.

Prior to the trial of Phase I, the district court granted Chemstar's motion for summary judgment and ordered that: (i) Liberty had a duty to defend Chemstar against all of the underlying plaster claims, because there was a *potential* for indemnification coverage under the Liberty policies; and (ii) Liberty breached its duty to defend Chemstar by abandoning the defense of the plaster claims. (Pet. App. 59a-62a)[4] With respect to Chemstar's bad faith claim, the district court denied the motion and set the matter for trial. Following ten days of trial, the jury then determined that, in failing to defend, Liberty had breached its duty of good faith and fair dealing toward Chemstar, and returned a special verdict awarding Chemstar $2,790,966 in compensatory damages. (Pet. App. 68a-71a) The jury also found that Liberty had acted with oppression, fraud or malice, and awarded punitive damages in the amount of $14 million. (Pet. App. 70a-71a)

After the jury verdict was returned, Liberty filed a motion for judgment NOV, for new trial, or for remittitur as to the Phase I trial. (Pet. App. 75a) The district court ruled that the jury's finding of a bad faith breach of the duty to defend was supported by sufficient evidence, that the punitive damage award was supported by sufficient evidence of oppression, fraud or malice as defined under California law, and that the amount of punitive damages bore a reasonable relationship to the actual damages. (Pet. App. 75a-80a)

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[4] As part of these rulings, the district court also held that Chemstar was the successor to Genstar Lime, an insured under the Liberty policies, and was therefore entitled to the same rights and benefits as Genstar Lime under the Liberty policies. (Pet. App. 60a)

The Court of Appeals' Decisions

On appeal, the Ninth Circuit unanimously affirmed the Phrase I judgment in its entirety. The court of appeals fully considered every issue raised by Liberty, and held, *inter alia*, that substantial evidence supported the district court's conclusion that Liberty had a duty to defend all plaster claims because the claims created the *potential* for coverage under Liberty's policies. (Pet. App. 27a-30a) The court also ruled that the bifurcation order was proper and "greatly helped simplify a legally complicated and issue-intensive case and did not separate intertwined issues so as to create confusion and uncertainty." (Pet. App. 31a) In addition, the court reviewed the record again and found that substantial evidence supported the jury's findings that Liberty had acted in bad faith and that its conduct justified punitive damages. The court further ruled that the punitive damages were not "excessive" or "grossly disproportionate." (Pet. App. 40a)

In separate opinions, the court of appeals also affirmed the district court's judgment in Phase II, which determined indemnification liability to Chemstar and contribution and other equitable issues among Chemstar's various primary and excess insurers. The lower courts determined that Liberty and other insurers whose policies were in effect at the date of the first manifestation of property damage were responsible for the indemnification of all the third-party claims.[5] The courts also determined that Liberty

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[5] The Phase II rulings included the following: (1) that the 28 claims constituted a single "occurrence" under the insurance policies; and (2) that a "manifestation" trigger of coverage applied to the claims, so that the policies in effect between March 15, 1985 and March 15, 1986 were obligated for the defense and indemnity of all plaster claims. (Pet. App. 14a, 18a) The court also ruled that Liberty's March 15, 1985 to March 15, 1986 policy was exhausted on April 17, 1991. However, that ruling did not apply to Chemstar because Liberty and Chemstar had entered into a stipulation which provided that "[a]ny ruling [on exhaustion] shall not be considered, introduced or used in any way by Liberty

had no right to contribution from National Union, another primary insurer. (Pet. App. 48a, 104a) Liberty's petition does not seek review of any Phase II rulings.

REASONS WHY THE PETITION SHOULD BE DENIED

This case does not merit review. The decision below presents none of the established grounds for exercise of certiorari jurisdiction and, in any event, is plainly correct in the aspects challenged by petitioner.

The decision below is not in conflict with the decisions of this Court or any other court of appeals, and the court below did not depart from the accepted and usual course of judicial proceedings. Nor does the case present any novel or important question of federal law. Rather, it merely represents a straightforward application of settled California law regarding an insurer's defense obligations to a specific set of facts.

Nor is there any reason to hold this petition in abeyance pending the Court's decision in *BMW of North America, Inc. v. Gore, cert. granted*, 63 U.S.L.W. 3555 (U.S. Jan. 23, 1995) (No. 94-896). The constitutional issues presented in *BMW* have nothing in common with this case. First, unlike the defendant in *BMW*, Liberty has not been punished for transactions that occurred outside the state. Liberty's offending conduct took place entirely in California. Thus, the due process problem of extraterritorial punishment is not presented here.

Mutual and/or Chemstar in any proceeding, including any appellate proceeding relating to the Phase I judgment." (Chemstar's Phase II SUPP-C 20-25)

Given the above stipulation, the court of appeals found that Liberty's attempt to exonerate itself from liability to Chemstar based upon Phase II exhaustion rulings was "untenable." (Pet. App. 46a) The court also correctly noted that "Liberty cannot use a later decision on coverage to dispute the district court's earlier decision on duty to defend." (Pet. App. 30a) Liberty nevertheless continues to violate the stipulation (Pet. at 9), and its references to the Phase II exhaustion ruling in its petition are similarly untenable here.

Second, in the *BMW* case, the punitive damages were 500 times the compensatory damages. Accordingly, the petitioner in *BMW* raised questions as to excessiveness. In this case, the punitive damages were limited to five times the compensatory damages. Given that reasonable ratio and the well-supported findings of the trial court and court of appeals as to the gravity of Liberty's misconduct, whatever may be the result in *BMW*, that case will have no bearing on the correctness or reviewability of the decision below. Thus, the petition should be denied now; there is no reason to hold it for *BMW*.

I. THE LOWER COURTS' PROCEDURAL RULINGS PRESENT NO *ERIE* QUESTION OR OTHER ISSUE WARRANTING THIS COURT'S REVIEW.

With respect to the first Question Presented in the petition, this is a straightforward diversity action involving a district court's decision to bifurcate, under Rule 42 of the Federal Rules of Civil Procedure, the trial of the state law questions. Essential to Liberty's position is its attack on the trial court's evidentiary rulings in the different phases of trial. These evidentiary and procedural rulings do not qualify for this Court's consideration.

Petitioner's only effort to bring these procedural rulings within any of the recognized grounds for certiorari rests on the assertion that the rulings are somehow contrary to this Court's decision in *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938). Putting aside the problem that it was petitioner who removed the case to federal court in the first place—and thus hardly is in the position to invoke the "forum shopping" underpinning of *Erie*[6]—the assertion is baseless because there is no conflict between state and federal law. The real question Liberty presents is merely whether the trial court abused its discretion. That question clearly is not an appropriate basis for certiorari jurisdiction.

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[6] *Hanna v. Plumer*, 380 U.S. 460, 468 (1965); *see* Liberty's Petition ("Pet.") at 19-20 n.13.

A. Bifurcation Under Rule 42 Did Not Conflict With Any State Law.

Most fundamentally, there is no conflict between state and federal law, a fact which Liberty concedes.[7] First, bifurcation of the trial on duty to defend issues from ultimate indemnity issues was fully consistent with California substantive law regarding an insurer's duty to defend, and did not "alter" Liberty's rights. As the courts below recognized, California law imposes a duty on insurers to defend all claims that create a *potential* for coverage under a liability policy, regardless of whether the insurer ultimately is held liable for indemnification under the policy.[8] *See* further discussion in Point II, *infra*.

Second, Rule 42(b) bifurcation also accords with the procedure permitted under state law. California state courts are vested with the same discretion to bifurcate a trial when the "convenience of witnesses, the ends of justice, or the economy and efficiency of handling the litigation would be prompted thereby." CAL. CIV. PROC. CODE § 598. *See also* CAL. CIV. PROC. CODE § 1048(b) (court may order separate trial of any cause of action or any issue). A California state court judge's discretion to order separate trials will not be reversed absent an abuse of discretion. *McLellan v. McLellan*, 23 Cal. App. 3d 343, 353, 100 Cal. Rptr. 258, 264 (1972). Liberty cites no California decisional law which would have prohibited bifurcation had the matter remained in state court.[9]

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[7] Liberty acknowledges in its petition that there is no "patent difference between two competing procedural rules, as in prior *Erie* cases." (Pet. at 18)

[8] *See, e.g., Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 17 Cal. Rptr. 2d 210, 846 P.2d 792 (1993); *Montrose Chem. Corp. v. Superior Court*, 6 Cal. 4th 287, 24 Cal. Rptr. 2d 467, 861 P.2d 1158 (1993); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 54 Cal. Rptr. 104, 419 P.2d 168 (1966).

[9] Liberty's reliance on *Downey Sav. & Loan Ass'n v. Ohio Cas. Ins. Co.*, 189 Cal. App. 3d 1072, 1086, 234 Cal. Rptr. 835, 841 (1987),

Finally, even assuming differences in the application of Rule 42(b) and its state law counterparts, the incidental effects of any such differences on the litigants here would not violate the commands of *Erie* and the Rules Enabling Act. *See, e.g., Hanna v. Plumer*, 380 U.S. 460, 465, 473-74 (1965); *Byrd v. Blue Ridge Rural Elec. Coop., Inc.*, 356 U.S. 525, 540 (1958). Liberty's contention that Rule 42 was "misapplied" by the district court under the particular facts of this case (Pet. at 12, 20) simply does not raise any *Erie* question at all, let alone a substantial federal question warranting review. *Hanna v. Plumer*, 380 U.S. at 469-70.[10]

B. Liberty's Challenges to Evidentiary Rulings Are Not an Appropriate Subject for Review.

Liberty contends that the bifurcation order precluded it from introducing "crucial evidence" at the Phase I trial, thereby allegedly altering its state law rights. (Pet. at 11-12, 27) Liberty's complaint constitutes nothing more than its disagreement with the district court's evidentiary

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cert. denied, 486 U.S. 1036 (1988) is misplaced, because that case did not involve a liability policy where an insurer has an obligation to defend based upon the potential for coverage. Rather, *Downey* involved an action against an insurer for denial of benefits under a fidelity bond where the appellate court found that the trial court did not abuse its discretion by denying a request by the insurer to bifurcate trial on the denial of coverage claim from the breach of the implied covenant claim. Similarly, *Cook v. Superior Court for County of San Diego*, 19 Cal. App. 3d 832, 833, 97 Cal. Rptr. 189 (1971), did not concern bifurcation in the context of an insurance dispute.

[10] Rule 42(b), of course, is entitled to strong presumptive validity under *Hanna*, and is properly treated as controlling federal procedural law. *See, e.g., Sellers v. Baisier*, 792 F.2d 690, 694 (7th Cir. 1986) (bifurcated trials are permissible in federal court even where state law employed to determine substantive issues prohibits bifurcated trials); *Rosales v. Honda Motor Co.*, 726 F.2d 259, 262 (5th Cir. 1984) (district court's bifurcation of trial did not implicate *Erie*).

rulings in a fact-intensive, state law trial. *See Hirst v. Gertzen,* 676 F.2d 1252 (9th Cir. 1982). There is no basis for review. *United States v. Johnston,* 268 U.S. 220, 227 (1925) ("We do not grant certiorari to review evidence and discuss specific facts.").

Evidence relating to other insurers, other claims, retrospective premiums, and policy limits (Pet. at 13, 18) was not excluded because of bifurcation, but rather because such evidence was not relevant to Liberty's breach of its duty to defend and its covenant of good faith and fair dealing. (Pet. App. 87a) *See, e.g., Montrose Chem. Corp. v. Superior Court,* 6 Cal. 4th at 300 ("[f]acts merely tending to show that the claim is not covered, or may not be covered, but are insufficient to eliminate the possibility that resultant damages (or the nature of the action) will fall within the scope of coverage, therefore add no weight to the scales"). Contrary to Liberty's suggestion, state law does not entitle Liberty to the admission of irrelevant evidence, nor do the cases Liberty cites so state. *E.g., Walbrook Ins. Co. v. Liberty Mut. Ins. Co.,* 5 Cal. App. 4th 1445, 1455, 7 Cal.Rptr. 2d 513 (1992). Thus, the court of appeals properly concluded that the district court's evidentiary rulings were not in error; "Liberty has failed to show that this evidence was relevant or that its exclusion resulted in substantial injustice." (Pet. App. 34a)

In any event, Liberty presented all relevant evidence regarding its intent and understanding, as the court of appeals expressly found. (Pet. App. 35a) For example, Liberty was permitted to introduce testimony of its decisionmaker's perceptions of other persons' interests (RT 1370-71); to give legal conclusions relating to coverage (RT 1361, 1365-66); to introduce hearsay evidence based on the "state of mind" exception (RT 1363); and to introduce otherwise inadmissible evidence so long as it pertained "to what the witness knew and had in his mind at the time he made the decisions." (RT 1349) As for

policy limits and retrospective premiums, Liberty's decisionmaker testified that these considerations had nothing to do with his decision to deny coverage. (RT 1332; SUPP 178)

II. THE BIFURCATION DECISION WAS CLEARLY CORRECT, AND INVOLVED NO ABUSE OF DISCRETION.

In the procedural aspects challenged by petitioner, the decision below is not merely unremarkable. It is plainly correct.

There was no "misapplication" of Rule 42 by the courts below. The district court's decision to bifurcate the trial was grounded in the applicable state substantive law governing an insurer's obligations to its insured. Because California law provides that an insurer's duty to defend is separate and distinct from the duty to indemnify, the district court elected to adjudicate these issues separately. The decision to bifurcate the trial in this manner was within the sound discretion of the trial judge, and was affirmed under the appropriate standard of review by the Ninth Circuit. See *Hirst v. Gertzen*, 676 F.2d at 1261 (district court's decision to bifurcate must be upheld absent an abuse of discretion).

California law is settled that the duty to defend is broader than the duty to indemnify. An insurer must defend any action which creates even a potential for coverage under its policy. *Montrose Chem. Corp. v. Superior Court*, 6 Cal. 4th at 295; *Gray v. Zurich, supra.* It is also settled that the duty to defend is determined at the outset of the case, and exists " 'even where coverage is in doubt and ultimately does not develop.' " *Montrose*, 6 Cal. 4th at 295 (quoting *Saylin v. California Ins. Guar. Ass'n*, 179 Cal. App. 3d 256, 263, 224 Cal. Rptr. 493 (1986)). Thus, the court of appeals below correctly stated that "[i]f the insurer could justify its refusal to defend on the argument that coverage was not yet de-

cided, the duty to defend would collapse into the duty to indemnify." (Pet. App. 34)[11]

The California Supreme Court's recent decision in *Montrose* reaffirms the broad scope of an insurer's defense obligation, and well illustrates the lack of merit in Liberty's challenges to bifurcation. In *Montrose*, the plaintiff-insured had been sued by the United States and the State of California in an action for recovery costs under the Comprehensive Environmental Response Compensation and Liability Action of 1980 (42 U.S.C. § 9607, *et seq.*) ("CERCLA"). Montrose gave notice of the action to its insurers that had issued liability policies from 1960 to 1986, and asked the insurers to defend it. The insurers declined to accept the defense.

Montrose then brought an action against its insurers seeking an adjudication that they had a duty to defend the actions. The California Supreme Court affirmed the appellate court's determination that the insurers were required to defend and reiterated that "[a] liability insurer owes a broad duty to defend its insured against claims that create a *potential* for indemnity." 6 Cal. 4th at 295 (emphasis added). When potential liability is established by reference to the complaint, the terms of the policy, and extrinsic evidence, "the insurer must assume its duty to defend *unless and until it can conclusively refute that potential.*" *Id.* at 299 (emphasis added). The California Supreme Court also noted that, to avoid the possibility

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[11] Liberty cites no authority for the proposition that insurance coverage actions are frequently bifurcated to resolve coverage issues before breach of contract issues. (Pet. 12, n.9) Moreover, Liberty's assertion is contrary to the settled California rule that the duty to defend is determined based upon the existence of the *potential* for coverage. *Gray v. Zurich Ins. Co.*, 65 Cal. 2d at 276-277, 54 Cal. Rptr. at 112-113. As Liberty itself acknowledges in its petition, "California law requires that an insurer's duty to defend is measured by the complaint against the insured not by a hindsight consideration of whether the claim turns out to be covered." (Pet. at 18)

that a refusal to defend will subject the insurer to liability for bad faith, the insurer may seek a judicial determination that it owes no defense. *Id.* at 301.

As Liberty notes in its petition, the California Supreme Court is expected to decide the indemnification issue (relating to the "trigger" of coverage) in a second decision in the *Montrose* action, which has not yet been scheduled for argument. Thus, the California Supreme Court has effectively approved a procedure in *Montrose*—*i.e.*, deciding duty to defend issues before ultimate coverage issues—which exactly parallels the procedure followed by the district court here.[12]

Liberty also claims that the bifurcation order deprived it of its state law contribution rights against other insurers. (Pet. at 17-19) Liberty's assertion is incorrect for two reasons. First, evidence of the obligations of other insurers would have been entirely irrelevant to whether Liberty breached its duty to defend Chemstar, because California law is settled that an insurer's obligation to defend is independent of the obligations of other insurers. *Wint v. Fidelity & Cas. Co.*, 9 Cal. 3d 257, 263, 107 Cal. Rptr. 175, 179 (1973).[13] Second, the bifurcation order did not deprive Liberty of its claims against other insurers for contribution. Liberty fully litigated (and lost)

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[12] None of the cases cited by Liberty at page 15 of its petition involved bifurcation of duty to defend issues from ultimate coverage issues. For example, *Response of Carolina, Inc. v. Leasco Response, Inc.*, 537 F.2d 1307, 1324 (5th 1976), involved an antitrust case where the court noted that bifurcation between liability and damages should be "approached with trepidation" because the "dividing line between violation and damages is difficult to draw." The other cases cited by Liberty are similarly inapposite because they did not involve an insurer's defense obligations.

[13] Pursuant to California law, an insurer who has honored its obligation to defend its insured may maintain an equitable action against a breaching insurer for contribution to defense costs. *Continental Cas. Co. v. Zurich Ins. Co.*, 57 Cal. 2d 27, 37, 17 Cal. Rptr. 12, 18, 366 P.2d 455 (1961).

such claims in Phase II of this action. (Pet. App. 48a, 104a).

In short, Liberty has completely failed to demonstrate that the lower court "so far departed from the accepted and usual course of judicial proceedings" as to call for the exercise of the Court's supervisory jurisdiction. S. Ct. R. 10.1(a). In granting bifurcation of trial on Liberty's breach of the duty to defend from other issues, the district court not only fully conformed to the applicable substantive law, but also acted well within the range of discretion necessarily vested in trial courts to manage efficiently their dockets. Accordingly, the petition should be denied.

III. THE PUNITIVE DAMAGES AWARD FULLY CONFORMS TO THIS COURT'S PRIOR DECISIONS, RAISES NO NEW DUE PROCESS ISSUES, AND WILL NOT BE AFFECTED BY THE RESULT IN *BMW*.

Contrary to Liberty's claim, there is no reason for the Court to grant certiorari to consider whether the punitive damages were excessive in this case. Reduced to its essence, Liberty's attack on the punitive damages award is nothing more than a request for a trial *de novo* on the facts which the jury, trial judge and court of appeals found supported the award. Review should be denied.

The due process issues Liberty raises have been resolved by the Court in *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1 (1991) ("*Haslip*"), and *TXO Prod. Corp. v. Alliance Resources Corp.*, 113 S. Ct. 2711 (1993), in which the Court held that the common law method of assessing punitive damages afforded procedural due process. The common law approach, faithfully employed by the courts below, provides that the jury is instructed to consider the purpose of puntive damages and to consider the seriousness of the injury and the amount needed to deter the misconduct. The trial court then reviews the

award for excessiveness. Finally, the appellate court reviews the award. *Haslip*, 499 U.S. at 15. "Assuming that fair procedures were followed, a judgment that is a product of that process is entitled to a strong presumption of validity. Indeed, there are persuasive reasons for suggesting that the presumption should be irrebuttable." *TXO Prod. Corp.*, 113 S. Ct. at 2720.

As demonstarted below, in this case Liberty had the benefit of the "full panoply" of California protections to ensure the validity of punitive damages.[14] *Haslip*, 499 U.S. at 3. Under these circumstances, Liberty's petition is without merit.

A. Objective Factors Demonstrate That the Punitive Damages Were Reasonable.

Despite Liberty's complete failure to raise any issue not settled by this Court's prior decisions, Liberty continues to argue that the facts established at trial were insufficient to support the jury's finding that punitive damages were appropriate. In fact, this case suggests no indicia of unreasonableness, and the evidence was more than sufficient to support the jury's finding that Liberty acted with "fraud, oppression or malice" under applicable California law.

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[14] Liberty does not raise any challenge to the jury instructions in its petition, nor could it. The jury was properly instructed under California Civil Code Section 3294, pursuant to which Chemstar was required to establish by clear and convincing evidence that Liberty acted with oppression, fraud or malice toward Chemstar. In assessing punitive damages, the jury was instructed to consider: (1) the reprehensibility of the defendant's conduct; (2) the amount of punitive damages that would have a deterrent effect on the defendant in light of its financial condition; and (3) whether the award bore a reasonable relationship to the harm actually suffered. Whether to award punitive damages at all was within the discretion of the jury. (Pet. App. 70) "The instructions thus enlightened the jury as to the punitive damages' nature and purpose, identified the damages as punishment for civil wrongdoing of the kind involved, and explained that their imposition was not compulsory." *Haslip*, 499 U.S. at 19.

Most fundamentally, this is not a case where an insurer "guessed wrong," as Liberty contends. Substantial evidence established that Liberty was aware of its obligations to Chemstar and of the probable consequences of its wrongful denial of those obligations. (See discussion at pp. 3-4 *supra*) At trial, Liberty chose to defend its conduct by claiming that it believed that Chemstar was not an insured under its policies, a contention which the trial judge found "stirs the blood." (Pet. App. 78a). Liberty's internal documents and the testimony of its employees established that Liberty knew that Chemstar was an insured and knew that Chemstar was entitled to a defense.

Furthermore, the dispute leading to the imposition of punitive damages did not, as Liberty claims, concern a mere business dispute arising out of reasonable but differing interpretations of insurance coverage. As set forth above, this is not a case, as Liberty suggests, where there was any factual or legal basis for its abandonment of Chemstar's defense.[15] California law has been established for at least 30 years that an insurer is required to defend its insured if there is a *potential* for coverage under the policy. *Gray v. Zurich Ins. Co.*, 65 Cal. at 276-277.

In this case, the evidence established that: (1) Liberty knew from the beginning the full facts concerning Chemstar's acquisition of Liberty's named insured, Genstar Lime, and Liberty's resulting obligations to Chemstar;

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[15] Liberty implies in its petition, as it did in the Phase II proceedings below, that *Whittaker Corp. v. Allianz Underwriters, Inc.*, 11 Cal. App. 4th 1236, 14 Cal. Rptr. 2d 265 (1992), provides authority for its withdrawal from the defense in 1989. Liberty's reliance on *Whittaker* is misplaced. As the Ninth Circuit found in its Phase II opinion, *Whittaker* "never directly addressed" the coverage issue decided by the lower courts. (Pet. App. 24a) Rather, the issue in *Whittaker* was whether a claim arises at the time of the act that causes damage or at the time of manifestation. (Pet. App. 24a) Furthermore, neither *Whittaker* nor any other case could exonerate Liberty from honoring its duty to defend Chemstar. As correctly stated by the Ninth Circuit, "[a]ll that is necessary [for the duty to defend] is the *potential* of coverage." (Pet. App. 34a)

(2) Liberty knew that there was at least a potential for coverage under the Genstar Lime policies, based on the recommendations and conclusions of its own claims personnel; and (3) nothwithstanding this knowledge, Liberty abandoned the defense of Chemstar without consulting its claims personnel or reviewing its written guidelines, without contacting its insured, and without seeking any judicial determination of its obligations, after handling Chemstar's defense for nearly three years without a reservation of rights. (Pet. App. 78a). As the court of appeals recognized, this amounts to clear and convincing evidence that Liberty willfully abandoned Chemstar in breach of the duty of good faith inherent in the relationship between an insurer and its insured.[16]

Contrary to Liberty's assertion (Pet. at 24), the "harm" at stake to Chemstar was not the mere possibility of Liberty incorrectly declining to provide coverage under an insurance policy. The harm to Chemstar was predictable and grievous. Within two month of Liberty's decision to abandon Chemstar, approximately 15 to 20 homeowners who were concerned that their claims would be ignored filed lawsuits against Chemstar. (RT 715) Moreover, Chemstar was forced to begin its defense from scratch, which greatly increased its attorneys' fees and experts' costs. (RT 1262) Moreover, Liberty's principal witness admitted it was "pretty obvious" that Chemstar would be seriously affected by the decision to deny all coverage. (RT 1475-76; SUPP 225-26) In short, the abandonment of Chem-

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[16] While a "pattern and practice" of the defendant may be a relevant factor with respect to punitive damages. (*TXO Prod. Corp.*, 113 S. Ct. at 2722, n.28), Chemstar was not required to present evidence that Liberty's misconduct was part of such a "pattern" (Pet. at 23) under either California law or this Court's decisions. Additionally, Liberty's assertion that punitive damages were inappropriate because Liberty allegedly did not profit from its conduct toward Chemstar (Pet. 25-26) is contrary to evidence from which the jury could have reasonably determined that Liberty intended to and did derive a substantial financial gain by withholding insurance benefits due Chemstar.

star was calculated to and did leave Chemstar in the worst possible position.

This evidence was clearly sufficient for the jury to find malice and oppression. The jury also could well have found that Liberty fraudently misrepresented the facts regarding Chemstar's insurance coverage and consciously disregarded its rights, as the Ninth Circuit concluded. (Pet. App. 40a).

B. A Reasonable Relationship Exists Between the Harm and the Award.

This Court has held that a mathematical bright line cannot be drawn between a constitutionally acceptable and a constitutionally unacceptable award of punitive damages. *Haslip*, 499 U.S. at 18. While there is no litmus test for determining whether an award is constitutionally acceptable, "a 'general concern for 'reasonableness . . . properly enters into the calculus.'" *TXO Prod. Corp.*, 113 S. Ct. at 2720, quoting *Haslip*, 499 U.S. at 18. A relevant consideration for reasonableness is that the punitive damages should bear a reasonable relationship to the harm that has actually occurred. *TXO Prod. Corp.*, 113 S. Ct. at 2720.

In this case, Liberty's conduct was found to be "egregious" (Pet. App. 79a), and the magnitude of harm to Chemstar was substantial: $2.8 million, according to the jury's special verdict. Given these facts, the $14 million punitive damages award was reasonably related to the nature and extent of the harm. The punitive damages award was five times the amount of Chemstar's compensatory damages. This five-to-one ratio is far less than the ratio in *TXO*. *See TXO Prod. Corp.*, 113 S. Ct. at 2718 (affirming a punitive damages award 526 times greater than the actual damages); *see also Haslip*, 499 U.S. at 23 (punitive damages four times the amount of compensatory damages and 200 times the out-of-pocket expenses). The award simply does not approach the

"outer limit" of reasonableness on awards of punitive damages. *TXO Prod. Corp.*, 113 S. Ct. at 2720, n.24.

C. Liberty's Financial Worth Further Supports the Award.

The net worth of the defendant is a relevant factor in determining the amount of punitive damages necessary to provide a financial deterrent inducing the defendant to change its future behavior. *TXO Prod. Corp.*, 113 S. Ct. at 2723. In this case, the $14 million punitive damage award constitutes roughly two-thirds of one percent of Liberty's $2.1 billion surplus. (Pet. App. 40a) This too demonstrates that the punitive damages award was reasonable under the particular circumstances.

D. The Review Conducted by the District Court and the Court of Appeals Satisfied Due Process Requirements.

In *TXO Prod. Corp.*, the Court considered and rejected the same argument that Liberty makes here: that the lower courts' review was too "cursory" to satisfy due process requirements. (Pet. at 29) *See TXO Prod. Corp.*, 113 S. Ct. at 2724 ("While it is always helpful for trial judges to explain the basis for their rulings as thoroughly as is consistent with the efficient dispatch of their duties, we certainly are not prepared to characterize the trial judge's failure to articulate the basis for his denial of the [defendant's] motions . . . as a constitutional violation.").[17]

Contrary to Liberty's claim, the district court engaged in a thoughtful analysis of the relevant factors regarding the reasonableness of the award. The district court reviewed in detail the facts established at trial regarding Liberty's

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[17] The procedures followed by the courts below bear no resemblance to the constitutional deficiency of the law at issue in *Honda Motor Co. v. Oberg*, —— U.S. ——, 114 S. Ct. 2331 (1994), in which Oregon impermissibly denied any judicial review of compensatory or punitive damages for excessiveness.

conduct, and noted that Liberty's "conclusion that Chemstar was not an insured inexplicable, even astounding . . . ." (Pet. App. 77a) The district court concluded that the jury's determinations "were solidly based in the evidence." (Pet. App. 79a) As noted above, the district court also concluded that the "facts in the case were as egregious as the court has ever seen in an insurance bad faith case in 20 years as a judge." (Pet. App. 79a)[18]

The court of appeals also considered the relevant factors bearing on the reasonableness of the award—including the reprehensible nature of Liberty's conduct, the relationship between the award and the actual harm, and Liberty's wealth—and concluded that the district court did not abuse its discretion in upholding the punitive damages award. The court of appeals expressly acknowledged that punitive damages are not available for even "gross or willful" breaches of contract, but require an insurer to have "acted maliciously, with an intent to oppress, and in conscious disregard of the rights of the insured." (Pet. App. 39a) The court then concluded that, "from evidence presented at trial, the jury could have inferred that Liberty fraudulently misrepresented facts regarding Chemstar's coverage and consciously disregarded Chemstar's rights under the policy." (Pet. App. 40a)

The Ninth Circuit also considered the award in the context of other punitive damages awards upheld by California courts, and found that California courts had upheld awards with much larger ratios between punitive damages and compensatory damages, and which constituted larger percentages of net worth (Pet. App. 40a)[19] Based on the

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[18] At trial, Chemstar called an industry expert, Edward McKinnon, who testified that Liberty's conduct constituted the worst bad faith failure to defend that he had ever seen. (RT 837-38; SUPP 171)

[19] The Ninth Circuit noted *Moore v. American United Life Ins. Co.*, 150 Cal. App. 3d 610, 636, 197 Cal. Rptr. 878 (1984) (83:1 ratio between compensatory damages and punitive damages), and *Chodos v. Ins. Co. of N. Am.*, 126 Cal. App. 3d 86, 103, 178 Cal.

entire record, the Court concluded that the award was not excessive as a matter of law. (Pet. App. 40a)

E. There Is No Reason to Hold This Petition Pending the Decision for *BMW*.

Whatever this Court may hold in *BMW*, this decision would not be affected. The constitutional issues presented in *BMW* are not at issue in this case, where there is no question of extraterritorial punishment. Further, in this case, neither the amount of punitive damages nor the findings below raise any issue as to excessiveness. Thus, there is no reason to hold this petition pending the decision in *BMW*.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be denied.

Respectfully submitted.

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Rptr., 831 (1982) (40:1 ratio between compensatory damages and punitive damages).